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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA, APPELLANT

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE UNITED STATES

OPINION BELOW

The memorandum opinion of the district court (App. 333-362), accompanying its order of dismissal (J.S. App. B, 69-70), is reported at 374 F. Supp. 95.

JURISDICTION

The memorandum opinion and order of the district court were entered on December 14, 1973. The notice of appeal to this Court (App. 363) was filed on February 11, 1974. On March 14, 1974, the Chief Justice extended the time for docketing the appeal to May 13, 1974, and the appeal was docketed on that date. Probable jurisdiction was noted on October 15,

1974 (App. 364). The jurisdiction of this Court is conferred by Section 2 of the Expediting Act, 15 U.S.C. 29.

QUESTIONS PRESENTED

The Investment Company Act of 1940 imposes a variety of restrictions upon the sale, distribution and redemption of mutual fund shares. The Act also gives specified regulatory authority over the mutual fund industry to the Securities and Exchange Commission and to associations of securities dealers registered by the Commission pursuant to the Maloney Act of 1938. Open-end mutual fund shares are sold through a principal underwriter who distributes the shares to broker-dealers, most of whom are members of the National Association of Securities Dealers, Inc., the only registered association. Section 22(d) of the Investment Company Act permits the fund to specify the price at which its shares may be sold by the fund, the fund's principal underwriter, or dealers to investors or persons other than a principal underwriter or a dealer. Section 22(f) prohibits a mutual fund from restricting the transferability or negotiability of its shares except in conformity with an applicable registration statement and such rules as the Commission may have adopted.

The questions presented are:

1. Whether the resale price maintenance required in primary distribution by Section 22(d) also by implication exempts from the antitrust laws combinations and agreements to suppress competition in secondary markets for already outstanding mutual fund

shares involving sales between dealers or sales between investors made through brokers.

2. Whether Section 22(f) creates an exemption from the antitrust laws for such combinations and agreements.

3. Whether the Investment Company Act and the Maloney Act create a regulatory scheme so pervasive and inconsistent with the antitrust laws that it impliedly exempts all possible restraints in the distribution and sale of mutual fund shares.

STATUTES INVOLVED

Section 1 of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, provides in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal * * *.

Sections 22(d) and (f) of the Investment Company Act of 1940, 54 Stat. 824, as amended, 15 U.S.C. 80a-22(d) and (f), provide in pertinent part:

> (d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal un-

derwriter, or the issuer, except at a current public offering price described in the prospectus. * * *

(f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Sections 15A(b)(8) and (n) of the Securities Exchange Act of 1934, 48 Stat. 895, as added by Section 1 of the Maloney Act of 1938, 52 Stat. 1070, as amended, 15 U.S.C. 78*o*-3(b)(8) and (n), authorizing securities associations registered with the Commission to engage in a degree of self-regulation, subject to specified review by the Commission, provide:

(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

* * * * *

(8) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimi-

nation between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

* * * * *

(n) If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail.

STATEMENT

The United States initiated this civil antitrust action under Section 4 of the Sherman Act, 15 U.S.C. 4, seeking injunctive relief against the appellees' violations of Section 1 of that Act, 15 U.S.C. 1. The defendants are the National Association of Securities Dealers, Inc. ("NASD") and certain mutual funds,[1] mutual fund underwriters,[2] and securities broker-dealer,[3] all appellees here. The complaint alleges that, in violation of Section 1, the defendants have combined and agreed to restrict the sale and fix the resale prices of the shares of open-end mutual funds in "secondary market" transactions between dealers, or from an investor to a dealer (collectively the "secondary dealer"

[1] Massachusetts Investors Growth Stock Fund, Inc.; Fidelity Fund, Inc.; and Wellington Fund, Inc.

[2] The Crosby Corporation; Vance, Sanders & Co., Inc.; and The Wellington Management Company, Inc.

[3] Merrill Lynch, Pierce, Fenner & Smith, Inc.; Bache & Company, Inc.; Reynolds Securities Corp.; F. I. du Pont, Glore Forgan, Inc.; E. F. Hutton, Inc.; Walston & Company, Inc.; Dean Witter & Company, Inc.; Paine, Webber, Jackson & Curtis, Inc.; and Hornblower & Weeks—Hemphill, Noyes, Inc.

or "interdealer" market), and between investors through a broker (the "brokerage market"). Complaint, App. 3–20. The district court granted appellees' motion to dismiss the complaint "on the merits and with prejudice for failure to state a claim upon which relief can be granted" (J.S. App. B, 69–70).

A. THE MARKETS FOR OPEN-END MUTUAL FUND SHARES [4]

This case involves alleged restraints on transactions in "open-end" mutual fund shares initially subject to a sales commission or "load." [5] A mutual fund is a company that invests in the securities of other corporations. An open-end investment company issues "redeemable securities" (15 U.S.C. 80a–5(a)(1)), which entitle the owner of the security to receive from the fund, on demand, his proportionate share of the fund's current net assets or the cash equivalent thereof. 15 U.S.C. 80a–2(a)(32). Transactions in mutual fund shares can occur in two markets: a primary distribution market and a secondary market.

1. *Primary Distribution.* In their initial or primary distribution chain, new shares issued by a fund are distributed through its principal underwriter (often an affiliate of the fund) to dealers with whom the un-

[4] The descriptions of the markets involved are based largely upon the allegations of the complaint (¶¶ 3, 9–14, App. 4–5, 7–9), which must be taken as true (see p. 17, *infra*).

[5] There are also "closed-end" investment companies, whose shares are not redeemable and traditionally are traded in the public market at substantial discounts from asset value. There are a number of "no load" open-end funds, which do not operate through brokers but sell directly to investors at net asset value. This case does not involve either of those types of funds.

derwriter has sales agreements, and then to investors (Compl. ¶ 9, App. 7). Under the Investment Company Act, an "underwriter" is a person who purchases shares wholesale from the issuer for sale to dealers; a "dealer" buys and sells shares for his own account; a "broker" buys and sells, as an agent, for the accounts of others. 15 U.S.C. 80a–2(a)(6), (11) and (40).[6]

Section 22(d) of the Investment Company Act of 1940, 15 U.S.C. 80a–22(d), requires that funds distribute their shares either to or through a principal underwriter or at a "current public offering price" described in the prospectus. If the class of security is being currently offered to the public by or through an underwriter, Section 22(d) also requires that principal underwriters and dealers adhere to the current public offering price when selling to anyone other than a dealer, a principal underwriter or the issuing fund.[7] The current public offering price is equal to the daily prorated "net asset value" of the fund's portfolio of investments, plus a sales commission ("load")

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[6] The term "broker-dealer" is not defined in the Investment Company Act. It applies in the securities industry to individuals and firms that function in particular securities transactions either as a "broker" or as a "dealer." See also p. 22, *infra*, n. 17.

[7] If shares are sold by a dealer in the primary distribution chain (a contract dealer) to a dealer not in that chain (a non-contract dealer), they leave the primary distribution chain without first being sold to an investor. Section 22(d) permits However, because non-contract dealers are bound by the requirements of Section 22(d) concerning the public offering price when selling such shares to investors, this aspect of the interdealer market is in effect part of the primary distribution chain.

fixed by the fund. 15 U.S.C. 80a-2(a)(35). In recent years, commissions have generally been fixed at 8.5 percent of the public offering price (9.3 percent of the net asset value) of a share. Usually the 8.5 percent sales load is split at 1.5 percent for the principal underwriter and 7 percent for the dealer.

An investor wishing to liquidate his investment normally does so by redeeming the shares with the fund. Upon surrender, the fund pays the investor the current net asset value of the shares. Shares may also be redeemed through dealers (Comp. ¶9, App. 7).

Although they are not required by law to do so, most open-end mutual funds engage in continuous public offerings of new shares; a minority, however, have voluntarily "closed up," either intermittently or on a long term basis, by discontinuing sales of shares. SEC Staff Study, *On the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940,* A-118 to A-120 (1972) (*"SEC Staff Study"*). By contrast, all funds are legally obliged to redeem their shares at any time. 15 U.S.C. 80a-22(e).[8]

2. *The Secondary Market.* The secondary market consists of transactions in shares that have already passed through at least part of the primary distribution network. It includes an "interdealer market" and a "brokerage" market between investors. Shares bought and sold in the secondary market would ordinarily be shares already in circulation, as distin-

[8] Holders of shares in closed-up funds often choose to sell them to broker-dealers, rather than to redeem them from the fund, in order to obtain a known price and quick cash payment, and for convenience. *SEC Staff Study* A-119.

guished from new shares in the primary distribution chain (but see p. 7, *supra*, n. 8). Consequently, the price range in the secondary market is limited by the primary market price and the redemption value of the shares.

Since sellers can always redeem shares at their net asset value, they will not ordinarily sell for less. Since buyers can always obtain shares (except on the infrequent occasions when the fund is not offering them) at the current public offering price, they will not ordinarily pay more. Only the "load" or sales commission can be affected by sales in secondary markets. Since the transactions are in shares already outstanding, they cannot change the funds' per share net asset value.

A few broker-dealer firms, acting as dealers, currently make markets with other dealers in the most widely-held mutual fund shares.[9] Other dealers with customers wishing to acquire or liquidate shares can go to these firms without dealing with the fund itself or the principal underwriter.[10] This market does not ordinarily produce any monetary advantage to a "buying" investor, since Section 22(d) requires that all dealer sales to investors be made at the fixed public offering price, if the shares are currently being offered to the public by or through an underwriter.

[9] Sales in this interdealer market accounted for less than one-tenth of one percent of total 1970 mutual fund share sales. *SEC Staff Study* A-113.

[10] Many dealers are bound, however, by restrictive agreements with principal underwriters forbidding trading on the interdealer market. The legality of these agreements is one of the issues in the present action.

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It can, however, produce an advantage to "selling" investors because a dealer may be willing to pay more than net asset value for the shares. The principal underwriter's 1.5 percent spread, which is avoided in the secondary market, offers one opportunity for dealers to pay selling investors small increments above net asset value without cutting into their own profits. Furthermore, the interdealer market may permit the selling investor to dispose of his shares more quickly and easily than by redemption through the fund or its underwriter.[11]

Brokerage market transactions, in which investors sell to one another through intermediary brokers, could likewise provide an opportunity for negotiation of a price between the public offering price (which includes the 8.5 percent load) and the net asset value (at which the fund is required to redeem), thus benefitting both parties to the transaction.[12]

B. THE ANTITRUST VIOLATIONS ALLEGED IN THE COMPLAINT

Count I of the complaint alleges that NASD and its members (including the appellee broker-dealers and underwriters) have combined to "prevent the growth of a secondary dealer market and a brokerage market in the purchase and sale of mutual fund shares" (Compl. ¶¶ 15–18, App. 9–10). The complaint alleges that the NASD and its members have (a) established and maintained rules[13] that inhibited the

[11] *SEC Staff Study* A–110.

[12] It appears that no such brokerage actually exists today. The legality of such a market, and the factors which may have suppressed it, are at issue in the present action.

development of secondary dealer and brokerage markets; (b) induced broker-dealers and principal underwriters to enter into restrictive sales agreements designed to suppress the development of such markets; (c) distributed misleading information concerning the legality of a brokerage market and discouraged persons from participating in it; and (d) suppressed market quotations for the secondary dealer market. (See, *e.g.* GX 14–19, App. 268–280.)

Counts II through VIII allege that the appellee mutual funds and their principal underwriters and broker-dealers have "entered into and maintained contracts and combinations * * * in unreasonable restraint of the aforesaid trade * * *" (Compl. ¶¶ 22, 28, 34, 40, 46, 52 and 57, App. 10, 11–12, 13, 14, 15, 16, 17), consisting of specific contractual agreements between the broker-dealers and the principal underwriters ("sales agreements") and between the principal underwriters and their respective mutual funds ("underwriting agreements"). The sales agreements, the complaint alleges, contain restrictive provisions directed towards prohibiting the participation of the broker-dealer in competitively-priced brokerage or interdealer markets. The underwriting agreements, it is alleged, not only prohibit the principal underwriter from participating in transactions in the secondary markets, but also, in one instance, obligate the principal underwriter to require that broker-dealers, in turn, agree to such restrictions (Compl. ¶¶ 22, 23, 28, 29, 34, 35, 40, 41, 46, 47, 52, 53, 57, 58, App. 10, 11–12, 13, 14, 15, 16, 17). See, *e.g.*, App. 34–38, 44–56, 63–69, 75–87, 100–115, 121–135, 138–152, 156–224.

[13] See p. 51, *infra*, n. 47.

The results of such agreements and other concerted conduct, the complaint alleges, have been to restrict the purchase and sale of fund shares largely to a primary distribution system, to curtail or eliminate secondary brokerage markets, to fix illegally the price of those secondary brokerage transactions which have been permitted by certain funds, and to deprive the public of the benefits of free and open competition in a secondary dealer and brokerage market in mutual fund shares (Compl. ¶¶ 18, 24, 30, 36, 42, 48, 54, 59, App. 10, 11, 12, 13, 14, 15, 16, 17).

The complaint seeks an injunction prohibiting the appellee funds, underwriters and broker-dealers from including and enforcing restrictive provisions in their selling agreements, and prohibiting NASD activity designed to discourage secondary brokerage and inter-dealer markets.

C. THE DISTRICT COURT'S DECISION

On motions by the appellees filed before discovery and trial, the district court dismissed the government's complaint with prejudice (J.S. App. B, 69–70). First, the court held that "Congress designed §§ 22(d) and 22(f) [of the Investment Company Act] to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is 'incompatible with the maintenance of (an) antitrust action' " (App. 354).

Basing that holding upon its reading of the legislative history of Sections 22(d) and 22(f), the court

observed that prior to the passage of the Investment Company Act a secondary market in open-end mutual fund shares had existed—the so-called "bootleg market." Sections 22(d) and 22(f), the court said, were aimed at suppressing the "cut-price competition" in this market which had caused "discrimination between similarly situated investors" (App. 348–349, 353). The court believed this conclusion to be supported by the fact that in 1967 and 1969 Congress had been asked to repeal or modify Section 22(d) but did not do so, and the court stressed testimony from the 1967 and 1969 hearings in which several persons broadly declared that Section 22(d) prohibits all price competition in broker or dealer mutual funds transactions (App. 349–352).

Second, the court concluded that the Investment Company Act and the Maloney Act commit the supervision and control of mutual fund transactions exclusively either to the oversight regulatory authority of the Commission or to the self-regulatory power of the NASD, the latter being subject to the Commission supervision and review (App. 355–361). The court reasoned that the "pervasive regulatory scheme" of the Investment Company and Maloney Acts was intended to replace the "usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares" and results in an implied immunity for the challenged practices (App. 361). The court stated that the case presents no question of primary jurisdiction (App. 361, n. 59).

SUMMARY OF ARGUMENT

In Section 22 of the Investment Company Act of 1940, Congress carefully defined the circumstances in which the shares of mutual funds may be the subject of resale price maintenance. It intended that at the end of the primary chain of distribution of such shares from the fund to investors, through underwriters and dealers, there be only one price to all investors (including "insiders" connected with the fund), consisting of the daily *pro rata* net asset value of the shares plus a fund-prescribed commission. Interdealer transactions were expressly excluded from the resale price maintenance requirements of Section 22(d), nor were sales between investors through brokers covered. Congress thus "marked the limitations beyond which price fixing cannot go." *United States* v. *McKesson & Robbins, Inc.*, 351 U.S. 305, 316. The courts "are not only bound by those limitations, but * * * are bound to construe them strictly, since resale price maintenance is a privilege restrictive of a free economy." *Ibid.*

The complaint alleges that the appellee funds, underwriters, and dealers, by an elaborate system of agreements and understandings arranged through appellee NASD and by other means, have sought to prevent the establishment of any secondary market in mutual fund shares, consisting either of transactions between dealers or transactions between investors made through brokers. This collective foreclosure of a secondary market goes beyond the purpose of Section 22, which was, by assuring a single public price to all investors buying newly issued shares, to prevent

discriminatory insider trading and dilution of asset value. A secondary market for already outstanding shares cannot aid insiders or dilute the funds' net asset value. Such a market can, however, provide an alternative method for investors to buy and sell outstanding shares at more favorable commission rates.

The appellees' restrictive agreements barring their participation in competitive secondary markets have not been approved by the Commission and, in any event, are not authorized by Section 22(f) of the Investment Company Act, which prohibits a mutual fund from restricting the transferability or negotiability of its shares except as outlined in that section. Not only do the challenged agreements go beyond the restrictions covered by Section 22(f), but that provision was not intended to supplant the prohibitions of the antitrust laws. Rather, it supplements other legal limitations that might be applicable to such restrictions.

By going beyond the narrow scope of conduct authorized by Section 22, appellees have violated Section 1 of the Sherman Act, the principal guarantee of this nation's fundamental commitment to competitive free enterprise. Nothing in the language or history of the Investment Company Act or the Maloney Act supports the district court's view that Congress intended an exemption from the antitrust laws broader than those acts expressly provide. On the contrary, the district court failed to give weight to two well-established doctrines: that repeals of the antitrust laws by implication are disfavored, and that exemptions for activities

subject to direct government regulation, or to a statutory duty of self-regulation, are implied only to the extent necessary to make the regulatory acts work, and even then only to the minimum extent necessary. *United States* v. *Philadelphia Nat'l Bank,* 374 U.S. 321, 350–351; *United States* v. *McKesson & Robbins, Inc., supra,* 351 U.S. at 315–316; *Silver* v. *New York Stock Exch.,* 373 U.S. 341, 357.

ARGUMENT

I. THE UNQUALIFIED SUMMARY DISMISSAL OF THE GOVERNMENT'S ANTITRUST CLAIMS WAS IMPROPER

A complaint should not be dismissed "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley* v. *Gibson,* 355 U.S. 41, 45–46.[14] Summary dismissal is particularly inappropriate in antitrust cases alleging conspiracies (*Poller* v. *Columbia Broadcasting Sys., Inc.,* 368 U.S. 464, 473), involving developing areas of law (cf. *White Motor Co.*

[14] Although appellees moved to dismiss on the ground that the government's complaint failed to state a claim upon which relief can be granted, several appellees appended exhibits to their supporting memoranda and the government filed an affidavit describing certain attached documents in support of the allegations in its complaint. The district court's opinion referred only to the allegations of the complaint. If the motions are treated as if for summary judgment, because of the introduction of matters outside the pleading (Fed. R. Civ. P. 12(b), (c)), the material allegations of the complaint must be taken as true, as with a motion to dismiss, and the inferences to be drawn from the underlying facts contained in the additional materials must be viewed in the light most favorable to the government. *United States* v. *Diebold, Inc.,* 369 U.S. 654, 655. In any event, it would have been inappropriate to grant summary judgment before the government had completed discovery.

v. *United States,* 372 U.S. 253, 259–261) or presenting claims that particular restrictions are necessary to achieve the purposes of a regulatory statute. *Silver* v. *New York Stock Exch., supra,* 373 U.S. at 356–357. Without a factual record, the extent of the immunity based on such claims cannot be readily determined at the pleading stage. *Scheuer* v. *Rhodes,* 416 U.S. 232, 250; *Harwell* v. *Growth Programs, Inc.,* 451 F. 2d 240, 246–247 (C.A. 5), modified, 459 F. 2d 461, certiorari denied, 409 U.S. 876.

The complaint, whose allegations must be read in the light most favorable to the pleader upon consideration of a motion to dismiss (*e.g., Scheuer* v. *Rhodes, supra,* 416 U.S. at 236–237), states that the agreements between mutual funds and their principal underwriters, or between a principal underwriter and broker-dealers, are designed to restrict the development of secondary interdealer and brokerage market in mutual fund shares, and that the members of the NASD have engaged in a concerted effort to encourage the use of such restrictions and to suppress those secondary markets.

The collusive activity described in the complaint amounts, *inter alia,* to a boycott of secondary market brokers and dealers. Group boycotts or concerted refusals by traders to deal with other traders are *per se* violations of Section 1 of the Sherman Act, without regard to their effect upon the price, quantity or quality of the goods or services offered to the public. *Fashion Originators' Guild of America, Inc.* v. *Federal*

Trade Commission, 312 U.S. 457, 465–468; *Klor's Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207, 211–212.

Similarly, the challenged sales agreements and underwriting agreements restricting the participation of broker-dealers and principal underwriters in competitively-priced brokerage or interdealer markets constitute resale price maintenance agreements and customer restraints which *per se* violate Section 1 of the Sherman Act (*United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365, 372–373, 377–378; *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373, 407–409), even without proof of their effect upon prices or volume in secondary markets. See *United States* v. *Arnold, Schwinn & Co., supra*, 388 U.S. at 379; *United States* v. *McKesson & Robbins, Inc., supra*, 351 U.S. at 309–310.

Given the allegations of the complaint that, as the result of such contracts and other concerted activity, the purchase and sale of mutual fund shares have been confined largely to a primary distribution system, that secondary markets have been curtailed or eliminated, and that secondary market brokerage transactions have occurred at illegally fixed prices, the dismissal can be sustained only if Congress intended in the Investment Company Act and the Maloney Act to provide antitrust immunity for virtually any state of facts relating to suppression of competition in secondary markets that the government might prove. As we next show, Congress had no such intention.

II. SECTION 22(d) OF THE INVESTMENT COMPANY ACT DOES NOT AUTHORIZE THE CHALLENGED RESTRICTIONS ON A SECONDARY BROKERAGE OR INTERDEALER MARKET IN MUTUAL FUND SHARES

The district court concluded that a secondary market consisting of inter-investor and interdealer transactions could not coexist with the resale price maintenance mandated for the primary market. It held that "creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d), the repeal of which has several times been urged upon Congress with no success" (App. 345–346). From this premise the court concluded that Section 22(d) by implication repeals Section 1 of the Sherman Act as applied to collective suppression of secondary markets.

The court's premises are erroneous for a number of reasons. Repeal of Section 22(d) would involve opening the *primary* market to price competition. That is quite a different question from the question of the present effect of Section 22(d) on a *secondary* market. No relevant inference can be drawn, therefore, from Congress' refusal to repeal that provision *in toto.*

The language of Section 22(d), as it now stands, permits a secondary market. The legislative history confirms this, for it shows that Section 22(d) was addressed to abuses in the primary distribution of

mutual fund shares, not to secondary level transactions. Since a secondary market cannot, as the district court believed, undermine, or even adversely affect, primary distribution of fund shares at a "current public offering price," it was not a matter of concern to Congress.

Finally, the Commission has consistently ruled that Section 22(d) permits a secondary market for both brokered sales between investors, and interdealer transactions.

A. THE LANGUAGE OF SECTION 22(d) DOES NOT PROHIBIT COMPETITIVE INTERDEALER AND BROKERAGE MARKETS

Section 22(d) of the Investment Company Act requires that a mutual fund sell shares either to or through a principal underwriter for distribution or at a current offering price described in the prospectus. 15 U.S.C. 80a-22(d). It further provides in relevant part that

> if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus.

In thus requiring that mutual funds, underwriters and dealers, when selling shares to the public, adhere to a "current public offering price described in the prospectus," Section 22(d) authorizes vertical price fixing. With respect to those transactions described in Sec-

tion 22(d), therefore, a limited exemption from the antitrust laws must be implied. But implied repeals of the antitrust laws are disfavored and must be strictly construed (*e.g., United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 350–351; *United States* v. *McKesson & Robbins, Inc., supra,* 351 U.S. at 316; *United States* v. *Borden Co.,* 308 U.S. 188, 198–199), so that the scope of this exemption can be determined only by noting what Section 22(d) does and does not say.

Section 22(d) expressly excepts interdealer transactions from its resale price maintenance provisions, unambiguously stating that principal underwriters and dealers are permitted to sell mutual fund shares to other underwriters or dealers or to the issuer at other than the public offering price. As the interdealer market is expressly excluded from the coverage of Section 22(d), it provides no immunity from the antitrust laws for concerted conduct and contracts restricting participation in or fixing prices on interdealer sales.

Section 22(d) does not bar direct sales between investors, and does not mention "broker" at all. On its face, therefore, it does not apply to transactions in mutual fund shares between investors executed through a broker. Congress separately defined the terms "broker"[15] and "dealer"[16] in the Investment

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[15] "'Broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies." 15 U.S.C. 80a-2(a)(6).

[16] "'Dealer' means any person regularly engaged in the business of buying and selling securities for his own account,

Company Act, and used the terms individually and together in various sections of the Act.[17] Such usage indicates that Congress deliberately employed the term "broker" where it sought to cover brokers or brokerage transactions, and omitted the term where that was not its purpose. To read the term "broker" into Section 22(d) would unjustifiedly expand that provision to include brokerage transactions, in conflict with the established doctrine that statutes authorizing resale price maintenance—"a privilege restrictive of a free economy"—must be "strictly" construed. *United States* v. *McKesson & Robbins, Inc., supra,* 351 U.S. at 316.

The reason for the omission of brokers from Section 22(d) becomes clear when the role that brokers

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through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." 15 U.S.C. 80a-2(a)(11).

[17] "Broker" is used without any reference to a dealer in Sections 2(a)(6), 3(c)(2), 10(b)(1), 17(e)(1) and 17(e)(2), 15 U.S.C. 80a-2(a)(6), -3(c)(2), -10(b)(1), -17(e)(1) and (2). "Dealer" is used without reference to broker in Sections 2(a)(29), 2(a)(40), 22(c) and 22(d). 15 U.S.C. 80a-2(a)(29), -2(a)(40), -22(c), -22(d). Both "broker" and "dealer" are used together in Sections 1(b)(2), 2(a)(11), 9(a)(1) and (2), 12(d)(3), and 30(a), 15 U.S.C. 80a-1(b)(2), -2(a)(11), -9(a)(1) and (2), -12(d)(3), and -30(a). See 54 Stat. 789, *et seq.*

When Congress amended the Act in 1970 (84 Stat. 1413), it continued to employ the terms "broker" and "dealer" together in Sections 2(a)(19)(A)(v), 2(a)(19)(B)(v), 12(d)(1)(B) and (E)(i), 15 U.S.C. 80a-2(a)(19)(A)(v) and (B)(v), -12(d)(1)(B) and (E)(i). In addition, it also used the general term "broker-dealer" in Sections 22(b)(1) and (2), 15 U.S.C. 80a-22(b)(1) and (2).

play in mutual fund transactions is considered. A broker is not a principal party in a mutual fund transaction, but rather, as the statutory definition indicates (p. 21, *supra*, n. 15), an intermediary between buyer and seller. He acts as an agent. Because parties involved in securities transactions act in different capacities at different times, Congress has carefully identified the capacities covered by its authorization of some form of price fixing.

Section 22(d) reflects this care. A broker, as agent for buyer or seller, is identified with, and controlled by the statutory restrictions applicable to, that party. For example, if a broker were to act as agent for the purchaser in a mutual fund transaction between a selling dealer and a purchasing member of the public, the transaction would be covered by the requirement of Section 22(d) that sales by dealers to anyone other than a dealer, underwriter, or the issuer must be at the public offering price.[18] A brokerage transaction between two investors (*e.g.*, members of the public) would not be covered by Section 22(d) because that section does not speak in terms of, and hence does not restrict, a sale by one investor to another.[19]

Each subsection of Section 22 concerns transactions that are links in the primary distribution of shares from fund to underwriter to dealer to investor. None

[18] If the broker is treated as agent for the investor, the transaction becomes a dealer-to-investor sale, which Section 22(d) covers.

[19] Such a sale would necessarily be part of a secondary market. The primary distribution chain would have been completed once the first investor purchased from the fund, underwriter or dealer.

indicates a purpose to reach transactions between investors, whether conducted with or without a broker intermediary. In this respect, Section 22(d) may be analogized to state fair trade laws authorizing resale price maintenance in the initial distribution of a product but not validating agreements to set prices in the second-hand market. Cf. *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384.

B. THE LEGISLATIVE HISTORY OF SECTION 22(d) DEMONSTRATES THAT IT WAS NOT INTENDED TO ELIMINATE COMPETITIVE SECONDARY MARKETS

The Investment Company Act of 1940 had its origins in the Public Utility Holding Company Act of 1935, Section 30 of which authorized and directed the Commission to study investment trusts and investment companies and to report its recommendations to Congress, 49 Stat. 837, 15 U.S.C. 79z–4. The Commission conducted a comprehensive investigation and submitted to Congress a series of detailed reports on the structure and operations of the industry and its various problems. See generally Securities and Exchange Commission, *Report on the Study of Investment Trusts and Investment Companies,* H. Doc. No. 70, 76th Cong., 1st Sess.; H. Doc. No. 279, 76th Cong., 1st Sess., pts. 1–3 (*"Investment Trust Study"*). The third of these reports was devoted to "abuses and deficiencies in the organization and operation of investment trusts and investment companies." *Investment Trust Study* iii.

Following this report, a bill was introduced in the Senate (S. 3580, 76th Cong., 3d Sess.) reflecting the views of the Commission. An identical bill was

introduced in the House (H.R. 8935, 76th Cong., 3d Sess.), but it was not the subject of hearings. Extensive hearings were held, however, on the Senate bill and counterproposals were submitted by various industry groups. See Hearings before a Subcommittee of the Senate Committee on Banking and Currency, on Investment Trusts and Investment Companies, 76th Cong., 3d Sess., pt. 1, 1–32 ("1940 Act Senate Hearings). After several weeks of negotiations, the Commission and industry representatives agreed upon the substance of revised legislation, and further hearings were held. Hearings before a Subcommittee of the House Committee on Interstate and Foreign Commerce, on Investment Trusts and Investment Companies, 76th Cong., 3d Sess. ("1940 Act House Hearings"). Thereafter, substitute bills were introduced in both houses (S. 4108, 76th Cong., 3d Sess.; H.R. 10065, 76th Cong., 3d Sess.). Both bills were reported favorably by their respective committees (S. Rep. No. 1775, 76th Cong., 3d Sess. ("Senate Report"); H. Rep. No. 2639, 76th Cong., 3d Sess. ("House Report")) and the House bill, including several minor amendments, was agreed to by the Senate. 86 Cong. Rec. 10069–10071.

The purposes of the Investment Company Act are outlined in Section 1 of the Act. Sections 1(b)(2) and (3), 15 U.S.C. 80a-1(b)(2) and (3), state with respect to pricing and distribution that:

> the national public interest and the interest of investors are adversely affected—
>
> (2) when investment companies are * * * operated * * * in the interest of directors, officers, investment advisers, * * * underwriters, brokers or dealers * * * rather than in the in-

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> terest of all classes of such companies' security holders;
>
> (3) when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities * * *.

These declarations of policy summarize the four principal abuses in pricing and distribution of mutual fund shares at which the legislative history indicates Section 22 was aimed: excessive sales loads, price discrimination between insiders and other investors, "riskless trading" and "dilution." See *Investment Trust Study* 847–874; 1940 Act House Hearings 58–59, 80–81, 99, 124; 1940 Act Senate Hearings 136–145, 187–188, 288–291, 332–336, 485, 514–527, 612, 660–663, 799–801, 836–863, 940–941, 949, 1047, 1053, 1085–1096, 1118; House Report 8, 20; Senate Report 6, 7, 16.

Section 22(b) deals with excessive sales loads. Section 22(d) was designed to correct the other three abuses. Characterized collectively as "trading against the fund" or "insider trading," these were dangerously prevalent in mutual fund trading practices prior to 1940. They were made possible by the existence of the "two-price" or "backward pricing" system of pricing mutual fund shares. *Investment Trust Study* 855–875.

Mutual fund share prices are now determined by the value of the underlying assets of the fund. (See Statement, *supra*, pp. 7–8). In the "backward pricing" system in effect prior to 1940, and to some degree until 1968,[20] the price of mutual fund shares was based

[20] See p. 29, *infra*, n. 25.

upon the value of the fund's portfolio as of the previous day's close of trading on the exchanges. This price, although determined in the late afternoon, did not go into effect until the opening of the exchanges the following morning.

In the interim period, two prices were known to the fund's operators: the present day's trading price based on the value of the fund's portfolio for the previous day, and the following day's price, based upon the portfolio's asset value for the present day. A person with access to both prices could wait until after the exchanges had closed in the late afternoon and then learn whether the following day's price would be higher or lower than the previous day's price. If the price were higher, he could buy into the fund after the exchanges had closed at the previous day's price, knowing that its shares would be selling at a higher price the following morning. An immediate redemption the following morning gave a "riskless trading" profit.[21] See, *e.g., Investment Trust Study* 865–871.

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[21] A Commission witness at the Senate Hearings summarized the problems as follows (1940 Act Senate Hearings 141–142):

> "Thus, in a rising market, when the rise results in an asset increase of the share that is greater than the load that is added to cover sales commissions and profits, a person can buy a security, after the two prices are known and established, at the lower of the two prices and almost immediately turn in the share for redemption for a higher price without any chance or risk of loss; he can't lose. * * * We found in our study for September that some insiders—that is officers of the sponsors, managers and underwriters—took advantage of the two price system to buy shares before the advance price went into operation and then almost immediately redeemed them at the higher known price."

Because such transactions increased the volume of shares outstanding but produced less cash for the fund than if subject to the next day's opening price, at which the insider redeemed, this "two-price system" led to "dilution" of the per share value of stock outstanding,[22] and invited insider-trading[23] abuses. *Id.* at 865–866. Although it would not benefit the average investor, who was required to pay the full sales load or commission on purchases, to sell immediately in a rising market, since the one-day increase in the value of shares was usually less than the load paid on the purchases (*Investment Trust Study* 865), insiders often could buy at little or no load and thus could take advantage of the two-price system to purchase and almost immediately redeem without cost or risk of loss. 1940 Act Senate Hearings, 142–145, 842. It was this form of "price discrimination" between in-

[22] The Commission gave a simplified illustration of dilution shortly after enactment of the 1940 Act. See *A Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc.*, 9 S.E.C. 38, 41 (1941). If a fund has net assets of $100,000 with 1,000 shares outstanding, and the value of the assets doubles during market hours, the per share value will also double, increasing from $100 to $200. If 1,000 more shares are then sold at the preceding asset value of $100 per share, the appreciation in value of the old shares is "diluted," with the result that the value of each old share increases from $100 to $150, rather than to $200. If the new investor then sold his shares the next day at the $200 net asset value then in effect, the dilution effect is compounded.

[23] "Insiders" refers to officials and employees of the investment company, its investment advisor and its principal underwriter, and affiliates thereof, and any other person in a position to buy shares of a mutual fund without paying the standard sales commission.

siders and other investors that led to the requirement of Section 22(d) that any sales load be imposed on all sales, including those to insiders.[24]

Congress, the Commission and the industry recognized that there were several possible ways of preventing the inequitable dilution caused by insider trading. See, *e.g.*, Sections 22(a), 22(b) and 30(d), S. 3580, 76th Cong., 3d Sess.; 1940 Act House Hearings 99; 1940 Act Senate Hearings 141–142, 515–526, 661. For example, a system of "forward pricing" could have been adopted, under which mutual fund shares would be priced at the next-computed current net asset value of the fund.[25]

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[24] As the Senate committee report stated:

> "The distribution and repurchase of the securities issued by investment companies have on occasion resulted in discrimination in favor of the management or other 'insiders' who have been able to acquire the securities and to have the companies repurchase them on a basis more favorable than that accorded public stockholders." (Senate Report 7; accord, House Report 8.)

It is in this sense, *i.e.*, discrimination between insiders and other investors, that Congress sought through the Investment Company Act to remedy the problem of "price discrimination."

[25] In 1968 the Commission adopted Rule 22c-1, 17 C.F.R. 270.22c-1, requiring forward pricing. Under the rule, all open-end investment companies must value their shares for purchases and redemptions at the next daily-computed net asset value of the fund after receipt of a purchase or redemption order. Rule 22c-1 provides:

> "(a) No registered investment company issuing any redeemable security, no person designated in such issuer's prospectus as authorized to consummate transactions in any such security, and no principal underwriter of, or dealer in, any such security shall sell, redeem, or repurchase any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such

During the hearings, however, the industry strongly objected to a forward pricing system. See, *e.g.,* 1940 Act Senate Hearings 514, 523.

A second possibility for controlling "in-and-out" trading by insiders would have been to have imposed holding periods on all sales of shares to insiders (*id.* at 859). Such a requirement was advocated in the hearings and contained in S. 3580, the original bill the Commission proposed. Section 30(d) of that bill provided that the "short-swing profit" provisions of Section 16 of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U.S.C. 78p) were to apply to investment company insiders.[26] As eventually enacted, however, the Investment Company Act applied the "short-

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security for redemption or of an order to purchase or sell such security.

"(b) For the purposes of this section, the current net asset value of any such security shall be that computed on each day during which the New York Stock Exchange is open for trading, not less frequently than once daily as of the time of the close of trading on such Exchange."

This rule, adopted pursuant to Section 22(c), 15 U.S.C. 80a-22(c), specifies the basis for computing "current net asset value" where applicable. It does not apply to commission rates, nor does it purport to apply to brokered sales between investors or other secondary market transactions not covered by Section 22(d).

[26] Section 30(d) provided in full:

"Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of outstanding securities (other than short-term paper) of which a registered investment company is the issuer, or who is a director or an officer of such a company, shall be subject to the same duties and liabilities as those imposed upon certain beneficial owners, directors and officers by section 16(b) of the Securities Exchange Act of 1934."

Section 16(b) of the Securities Exchange Act allows an issuer to recover any profits obtained by officers, directors or ten percent beneficial owners as a result of any purchase and sale, or sale and purchase of the securities within any six-month period. 15 U.S.C. 78p(b).

swing profit" restrictions only to closed-end investment companies (see p. 5, *supra*, n. 6). 15 U.S.C. 80a–29(f); 1940 Act House Hearings 99.

Congress adopted a third method: the requirement of a uniform "current public offering price" on open-end fund sales to all investors. Where the fund sells through an underwriter-dealer system, this price had to include the commission or sales load. Section 22(d) embodies this alternative.

Section 22(d) had its origin in a reference during the hearings to Ohio's "blue sky law," which cured in-and-out purchasing by requiring insiders as well as all other investors to pay the full public offering price, including the sales load. 1940 Act Senate Hearings 526–527. At the conclusion of the initial hearings, the industry offered a series of proposals for legislative action (*id.* at 1052–1059), which said, with respect to Section 22 (*id.* at 1057; emphasis added):

> Distribution, redemption, and repurchase of redeemable securities, section 22 of the present bill: These sections have to do primarily with problems of dilution and excessive sales loads. As there are problems affecting distributions and transactions with dealers, all of whom are members of a securities association organized and regulated under the Maloney Act, this section should provide that the rules of such securities association may deal with this subject matter. *This section should also provide that no securities issued by an investment company shall be sold to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors.* * * *

The underscored portion of this proposal was then incorporated in a memorandum of agreement between the Commission and industry spokesmen (1940 Act House Hearings 99) and was reflected in Section 22(d) as enacted. However, in neither the House report, the Senate report nor in any other pertinent discussion of Section 22(d) was there any mention of the secondary market in mutual fund shares.[27]

In sum, Section 22(d) was enacted to protect open-end mutual fund investors against dilution of their

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[27] The Investment Trust Study had referred to the secondary or "so-called bootleg" market primarily in one paragraph which was descriptive rather than critical and which related to the issues to which Section 22(f) rather than Section 22(d) was directed. See pp. 42–50, *infra*. This section of the Study stated, in its entirety (*id.* at p. 865; footnote omitted):

> "The so-called 'bootleg market' was the market made by dealers who traded in the shares of open-end investment companies without the authority of the principal distributors for those companies. These dealers would often offer a little more than the published redemption price and ask a little less than the published sale price. In an active market, the unauthorized dealer could still get a greater spread than the authorized dealer. A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short. Such operations actually had the effect of initiating a small scale price war between retailers and tended generally to disrupt the established offering price. Certain open-end investment companies attempted to overcome this by restricting the negotiability of their shares, providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company."

Although the secondary market in mutual funds was not unlawful, the principal underwriters who disliked it called it the "bootleg," "grey" or "price-cutting" market. *Investment Trust Study* 328, n. 85; *SEC Staff Study* A–114.

equity due to "in-and-out" trading by insiders.[28] It was never intended to, and does not, sanction the elimination of secondary interdealer and brokerage markets in which prices are set by normal competitive processes.

C. THE EXISTENCE OF A COMPETITIVE SECONDARY MARKET IS NOT INCONSISTENT WITH THE PRIMARY DISTRIBUTION SYSTEM ESTABLISHED BY SECTION 22(d)

The district court erroneously concluded that the existence of a secondary market was inconsistent with the primary distribution system established by Section 22(d) (J.S. App. 46–51). As we have just shown, Congress' purpose in enacting Section 22(d) was not to assure that a mutual fund and other elements in the primary chain of distribution of its shares were to be immune from any and all competition from secondary markets. Rather, it was to avoid dilution resulting from discriminatory pricing in favor of insiders, and unduly large sales loads. A secondary market could not contribute to dilution, whether by insiders or other investors, nor could it cause excessive sales loads.

As described above (see pp. 7–10, *supra*), the shares traded in the secondary market have already been

[28] The role of Section 22(d) in preventing dilution from insider trading is complemented by Sections 22(a) and 22(c), which authorize the NASD and the Commission to issue rules regulating transactions between funds, underwriters and dealers in order to preclude sales below net asset value and redemptions above net asset value, which would have a diluting effect. 15 U.S.C. 80a–22(a) and (c) (see pp. 53–54, *infra*). Although dilution could still occur if the fund sold directly at a reduced price to insiders who were not NASD members, Section 22(d) prohibits such transactions.

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purchased by an investor or a dealer from a member of the primary distribution chain at the price fixed by the fund or underwriter. The fund has already received full payment for those shares. Any profits or losses as a result of their resale in the secondary market flow solely to the purchaser or seller. Investor protection against excessive profits or commissions is provided by the fact that the shares are usually available at the current public offering price and can be redeemed at net asset value.[29]

For reasons previously noted (see pp. 9–10, *supra*), the prices in a competitive secondary market are not likely to differ substantially from the price established in the primary distribution chain. While an active competitive secondary market in a fund's shares may result in somewhat lessened demand for the fund's newly-issued shares being sold in the primary distribution system, that consequence would not be inconsistent with the existence of the primary distribution system, with its resale price maintenance. Section 22 (d) was not intended to ensure that a fund would have the maximum market for its newly-issued shares, to be sold at the fixed price, any more than state fair trade laws are intended to protect producers from competition from the second-hand market for their

[29] Any brokerage commission in the secondary market would not normally exceed the difference between these two primary market prices, which is equal to the sales load determined by the fund. Since, under Section 22(b), the sales load cannot be "excessive," 15 U.S.C. 80a–22(b), the competitively-determined brokerage commission would not be so either.

goods.[30] Competition from the secondary market may to some degree limit the attractiveness of shares whose price is maintained but that does not "undermine" the legal right to practice resale price maintenance, which is all that Congress gave. In sum, existence of a competitive secondary market is not inconsistent with the resale price maintenance authorized by Section 22(d).

D. FROM THE OUTSET THE COMMISSION HAS EXPLICITLY AND CONSISTENTLY HELD THAT THE INVESTMENT COMPANY ACT PERMITS COMPETITIVELY-PRICED INTERDEALER AND BROKERAGE TRANSACTIONS IN THE SECONDARY MARKET FOR MUTUAL FUND SHARES

Shortly after the passage of the Investment Company Act, the General Counsel of the Commission issued a formal opinion that Section 22(d) did not bar brokerage and interdealer transactions in mutual fund shares:

> In my opinion the term "dealer", as used in Section 22(d), refers to the capacity in which a broker-dealer is acting in a particular transaction. It follows, therefore, that if a broker-dealer in a particular transaction is acting solely in the capacity of agent for a selling investor, or

[30] The court also erred in assuming that a secondary market would result in redemptions in excess of sales, thus forcing liquidation of the fund (App. 348). While it is true that a secondary market permits an investor to redeem shares without having purchased them from the fund, those same shares would necessarily have come from an investor who did purchase them from the fund and sold them in the secondary market rather than redeem them from the fund. In short, the fund would merely experience one sale and one redemption rather than two sales and two redemptions.

for both a selling investor and a purchasing investor, the sale may be made at a price other than the current offering price described in the prospectus. Of course disclosure of the fact that the broker-dealer is acting as agent, and of the amount of his commission, must be made to his principal or principals in accordance with the requirements of the Rules and Regulations promulgated by the Commission under Section 15 (c)(1) of the Securities Exchange Act of 1934.

On the other hand, if a broker-dealer is acting for his own account in a transaction and as principal sells a redeemable security to an investor, the public offering price must be maintained, even though the sale is made through another broker who acts as agent for the seller, the investor, or both.

As Section 22(d) itself states, the offering price is not required to be maintained in the case of sales in which both the buyer and the seller are dealers acting as principals in the transactions. [Investment Company Act Release No. 78, March 4, 1941, 11 Fed. Reg. 10992.] [31]

One month later the Commission itself noted the existence of a competitive secondary market in mutual fund shares, with no suggestion that it was barred by Section 22(d).[32]

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[31] This opinion is listed as an authoritative interpretative release in the current Commission regulations, 17 C.F.R. 271.

[32] *A proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc.*, 9 S.E.C. 38, 46, n. 12 (1941):

"A secondary market is maintained in shares of open-end investment companies which more closely resembles the traditional over-the-counter market in other securities, but this mar-

In 1946 the Commission adopted the General Counsel's analysis in a case dealing in part with a purchase and sale of mutual fund shares. *Oxford Co.,* 21 S.E.C. 681. Citing the 1941 opinion, the Commission expressly held that Section 22(d) did not prohibit a dealer from engaging in brokerage transactions in mutual funds shares at prices other than the current offering price (21 S.E.C. at 690; footnotes omitted):

> The requirement of Section 22(d) * * * merely provides that no *dealer* shall sell to a customer except at the sponsor's current offering price. It does not apply to broker transactions, as we have long ago advised the trade. Acting as agent for the seller or as agent for buyer and seller (with appropriate disclosure), respondent, unrestrained by Section 22(d), could and should have made the best possible deals for its customers.

In 1972, in *Mutual Funds Advisory, Inc.,* Investment Company Act Rel. No. 6932 (Jan. 12, 1972), the Commission reaffirmed this principle, stating (*id.* at 3):

> At the outset, it should be pointed out that it does not appear that applicant has standing in the circumstances of this case to seek an exemption from the prohibitions of Sections 17(a)(1) and 22(d) of the Act. Those prohibitions apply to one who sells fund shares as "principal" or "dealer" or principal underwriter. It would seem * * * that

ket exists only in the range between the public offering price and the redemption price of the shares. Transactions in this secondary market are not prohibited by paragraph (j)(2) [proposed NASD Rule 26(j)(2)], which applies exclusively to the redemption of shares."

> application would act as broker for Fundpack * * *. Thus, applicant would not come under the prohibitions in Sections 17(a)(1) and 22(d) * * *.[33]

Finally, in a recent report submitted to the Senate Committee on Banking, Housing and Urban Affairs, the Commission repeatedly emphasized that Section 22(d) does not apply to brokerage transactions in mutual fund shares. SEC, *Report on Mutual Fund Distribution and Section 22(d) of the Investment*

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[33] In April 1973, the Chief Counsel of the Commission's Division of Investment Management Regulation issued an opinion almost identical to that issued by the General Counsel in 1941 (GX 5). Responding to the question whether broker-dealers with whom an underwriter had contractual agreements could net purchase orders and orders for liquidation for the fund's shares received on the same day, this opinion affirms the viability of the Commission's earlier interpretations and states that Section 22(d) does not prohibit brokerage transactions (*ibid.*):

"In Investment Company Act Release No. 78 (March 4, 1941), the Commission's General Counsel took the position that a broker-dealer acting solely in the capacity as agent for a purchasing or selling investor is not a "dealer" for the purposes of Sections 22(d), and thus could execute a transaction, assuming full disclosure of his agency capacity, at a price other than the current public offering price described in the prospectus. The Commission later confirmed that position on the meaning of "dealer" for purposes of Section 22(d). *In the Matter of Oxford Company, Inc.*, 21 S.E.C. 681. See, also, *In the Matter of a Proposed Amendment to the Rules of Fair Practice for the NASD, Inc.*, 9 S.E.C. 38, 44, 45, Investment Company Act Release No. 118 (April 19, 1941). Accordingly, the Act does not prohibit a broker-dealer from acting as an agent with respect to a client * * *. In summary, no provisions of the Act or rules thereunder would prohibit the practice you describe."

Company Act of 1940 (1974) ("*SEC Report on Mutual Fund Distribution*").[34] The Report expressly rejected the district court's conclusions in this case that restrictions on secondary brokerage transactions are necessary to prevent discrimination between similarly situated investors and to protect the primary distribution system mandated by Section 22(d).[35] Indeed, the Commission's report found no reason to "think the

[34] The report stated that "[b]y its terms, Section 22(d) does not apply to brokered transactions. Nevertheless, no secondary market in mutual funds has developed because uniform sales agreements between underwriters and broker-dealers effectively prohibit such a secondary market" (*id.* at 109; see *id.* at 105, n. 2; 107, n. 2), although "there is no statutory requirement that the offering price in the prospectus be maintained in a brokered transaction." *Id.* at 104. The Report did not discuss the interdealer market.

[35] The Report stated (p. 104, n. 4):

"In view of the fact that by definition the secondary brokerage market in a fund's shares is not part of that fund's primary distribution system, any differences in price that may occur between the secondary brokerage market and the primary distribution market cannot be said to be the product of a discrimination by the fund between similarly situated investors. Accordingly, we are in disagreement with the court in *Haddad*, *supra* at 94, 106 insofar as that court reasoned that the Commission's prior pronouncements respecting the applicability of Section 22(d) to brokered transactions were somehow defective because those pronouncements failed to deal with the problem of discrimination between similarly situated investors.

"The Court in *Haddad* also criticized the Commission's pronouncements concerning the applicability of Section 22(d) to brokered transactions on the ground that those pronouncements did not address the effect of brokered transactions at other than the stated offering price on the regulated distribution system. * * *"

existence of a brokerage market will have a material effect on the primary distribution system." *Id.* at 104, n. 4.

Although the Commission's interpretation of Section 22(d) related only to its compatibility with the performance of brokerage functions in the secondary market, and did not sanction dealer functions there, that limitation is immaterial to the issue in this case. The significant fact is that the agency has recognized that Section 22(d) does not prohibit, but indeed favors, transactions in the secondary market at competitively fixed prices different from the initial offering price or the fund's redemption price.

The contemporaneous interpretation of a statute, consistently adhered to over a long period, by an agency involved in drafting the statute and responsible for its implementation, is entitled to great deference. *Udall* v. *Tallman,* 380 U.S. 1, 16; see *Zuber* v. *Allen,* 396 U.S. 168, 192.

The district court, which did not have available the recent Commission report, gave little weight to the foregoing Commission construction of the Act. Instead, it relied upon its interpretation of statements by Commission witnesses and members of Congress at hearings nearly 30 years after passage of the Act (App. 348–352). However, as this Court observed concerning related legislation also enacted in 1940, "[t]he intent of Congress must be culled from the events surrounding the passage of the 1940 legislation. '[O]pinions attributed to a Congress twenty years

after the event cannot be considered evidence of the intent of the Congress of 1940.'" *Securities and Exchange Commission* v. *Capital Gains Research Bur., Inc.,* 375 U.S. 180, 199–200 (citations omitted); *accord, United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 348–349. Moreover, the statements were directed, not to the application of Section 22(d) to secondary markets, which are virtually non-existent, but to the different question whether Section 22(d) should be repealed entirely, or at least modified with respect to its basic regulation of pricing in the primary distribution scheme.[36]

The district court also disregarded appellees' own past recognition, shared by commentators, that a competitive brokerage market in mutual fund shares does not violate the Investment Company Act. In a portion of the NASD's manual concerning "Maintaining the Public Offering Price," an illustrative brokerage transaction is assumed to be at less than the public offering price and is characterized as a proper transtion under Section 22(d) (NASD Manual ¶ 5269; see p. 61, n. 54, *infra*). In addition, various letters and internal memoranda (GX 12, 26, 27 and 28, App. 263–266, 296–300) further evidence appellees' knowledge of the legality of such brokerage transactions under

[36] As a recent article demonstrates, such statements, like those of prior commentators, are not supported by close analysis of the history of Section 22(d). See Heffernan & Jorden, *Section 22(d) of the Investment Company Act of 1940—Its Original Purpose and Present Function*, 1973 Duke L.J. 975.

Section 22(d). Finally, the legality of the brokerage market is acknowledged in various commentaries.[37]

III. SECTION 22(f) OF THE INVESTMENT COMPANY ACT DOES NOT IMMUNIZE CONTRACTUAL RESTRAINTS ON SECONDARY BROKERAGE OR INTERDEALER MARKETS FOR MUTUAL FUND SHARES

A. SECTION 22(f) APPLIES ONLY TO RESTRICTIONS IMPOSED BY MUTUAL FUNDS ON THE TRANSFERABILITY AND NEGOTIABILITY OF SHARES AND DOES NOT AUTHORIZE RESTRAINTS IMPOSED BY AGREEMENTS AMONG UNDERWRITERS AND DEALERS

Section 22(f) provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

The district court held that this section "specifically empowered mutual funds to restrict the transferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rulemaking authority of the SEC * * *" (App. 354) and that "Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in

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[37] *E.g.*, Motley, *Federal Regulation of Investment Companies Since 1940*, 63 Harv. L. Rev. 1134, 1145 (1950); Greene, *The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940*, 37 U. Det. L.J. 369, 388, *n.* 79 (1960); 3 CCH Fed. Sec. L. Rep. ¶¶ 48774–48775.

full recognition of the antitrust implications" (*ibid.*). The court's conclusion, however, misinterprets both the language and legislative history of Section 22(f).

On its face, Section 22(f) contains a prohibition against any restrictions on the "transferability or negotiability" of mutual fund shares and the limited authority granted as an exception is applicable only to mutual funds themselves. A fund is authorized by Section 22(f) to impose such restrictions only if they are fully disclosed in the fund's registration statement, and, in any event, they must not contravene rules and regulations of the Commission.

The restrictions challenged in Counts II through VIII in the present case are not fund-imposed restrictions on the transferability or negotiability of shares of the sort addressed by Section 22(f). Rather, they are contractual agreements between principal underwriters and funds and between underwriters and broker-dealers. The fund shares involved in this case are, for example, "fully transferable" (GX 8, App. 254) or "transferable * * * in the customary manner" (GX 7, App. 253), as indicated both by statements in their prospectuses and by the absence of restrictions on transferability or alienability on the face of the security certificates (see p. 47, *infra*, n. 40). The contractual restrictions on distribution at issue here involve restraints of the distribution mechanism rather than restraints on the alienability or negotiability of the fund shares themselves. The shares are alienable and negotiable, but secondary markets in which to sell them have been artifically suppressed by the appellees.

Nothing in Section 22(f) sanctions the restraints challenged in the complaint. The district court's contrary assumption was based on the fact that Section 22(f) imposes conditions on the use, by funds, of restrictions on share transferability, and the requirements of full disclosure in registration statements and compliance with any rules concerning such restrictions that the Commission may adopt to protect investors (App. 353–354). The Commission has not adopted such rules, although it has stated in its recent Report on Mutual Funds (see pp. 38–39, *supra*) that it intends to do so if necessary to protect a secondary brokerage market. *SEC Report on Mutual Fund Distribution* vi.[38]

B. SECTION 22(f) MERELY PROVIDES FURTHER LIMITATIONS ON A FUND'S RESTRICTION OF THE TRANSFERABILITY OF ITS SHARES

1. The legislative history shows that Section 22(f) was intended to limit the practices of certain funds whose share certificates specified that the shares were not transferable except by redemption with the fund. Quite often these restrictions were not disclosed to investors before they purchased the shares. Because such restrictions deprived the investor of a valuable ownership right, Congress required their disclosure in the

[38] Moreover, by letter dated November 22, 1974, the Commission requested appellee NASD to amend its rules so as to prohibit agreements restricting broker-dealers from engaging in certain secondary market transactions at competitively determined prices and commission rates, in accordance with the Commission report. Letter from Ray Garrett, Jr., SEC Chairman, to Gordon Macklin, NASD President, November 22, 1974 (reprinted in Addendum to Appellee Dealers Brief). While the letter specified no time for a response, the Commission is authorized to alter the rules by its own order if NASD fails to act "within a reasonable time." 15 U.S.C. 78*o*–3(k)(2).

registration statement and authorized the Commission to regulate them. 1940 Act Senate Hearings 292–293.

The Commission-sponsored bill, which followed the Commission's report on investment company practices (see p. 24, *supra*), originally provided, in Section 22(d)(2), that the Commission was authorized, "in the public interest or for the protection of investors," to prohibit, by rule or order, "restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer." *Id.* at 16. The testimony of the Commission witness concerning this provision described the restrictions as a serious impairment of the investor's ownership rights and as a practice that should be permitted only subject to such restraints as the agency might impose to correct abuses disclosed by further study (*id.* at 292–293):

> There are some companies that have a provision in their certificates to the effect that you cannot sell that certificate to anybody else, and the only way you can sell it is to sell it back to the company. That is a technical problem. It presents a whole problem which they call the bootleg market. What happens is that dealers keep switching people from one company to another. In order to prevent these switches, some provisions require that you cannot make these switches but must sell the certificate back to the company. That is a big problem; but it seems to me they are taking away a very valuable indicium of the ability of the company, and it seems to me you are taking away a big portion of the owner's right of initiative.

* * * * *

> If this bill becomes law, and after we study the whole situation, if we feel there are abuses which cannot be corrected except by putting in a restriction on alienability, then we shall formulate rules, after discussing them with the industry.[39]

The industry counter-proposal made no reference to a provision concerning restrictions on transferability (1940 Act Senate Hearings 1057), which suggests that the industry did not regard even the relatively mild measure originally proposed as being in its interests. The Commission-industry agreement (see p. 25, *supra*) provided that "[r]estrictions on transferability of shares shall be subject to rules and regulations of the Commission." 1940 Act House Hearings 99. The Senate report stated, with respect to Section 22(f), only that the "negotiability of open-end securities may not be restricted in contravention of provisions which may be formulated * * *." *Id.* at 16. The House report described Section 22(f) as providing that "the negotiability or transferability of redeemable securities of open-end companies may not be restricted in contravention of rules and regulations which the Commission may prescribe." *Id.* at 20. Neither report referred to the secondary market in connection with Section 22(f), or suggested a general purpose to allow underwriters and dealers to make agreements concerning negotiability or transferability of shares.

2. Restrictions on the transferability of mutual fund shares, like other securities, have long been

[39] The same point was made briefly in the *Investment Trust Study* (*id.* at 865). See also p. 32, *supra*, n. 27.

subject to limitations imposed by state law as well as federal law, such as formal requirements that the restrictions appear on the face of the certificate[40] and substantive requirements that the restraints not be unreasonable.[41] Restrictions on transferability, prior to adoption of Section 22(f), would also have been subject to the general requirements of the antitrust laws. Yet, nothing in the language of Section 22(f) or its history suggests that, upon the enactment of Section 22(f), these other limitations on restrictions of transferability were rendered inapplicable to mutual fund shares.

[40] Article 8, Section 204, of the Uniform Commercial Code, which has been adopted by most states (*e.g.*, Mass. Laws Ann., C. 106, Sec. 8–204; Md. Code Ann., Art. 95B, Sec. 8–204), provides that any such restrictions, to be effective, must be noted conspicuously on the security certificate. See also Mass. Laws Ann., C. 156B, Sec. 27; Md. Code Ann., Art. 23, Sec. 27(c); 8 Del. Code, Sec. 194. Appellee funds' share certificates contain no such notice (GX 1, 2, 3, App. 233–242).

[41] Particular stock transfer restrictions contained in articles of incorporation, contracts of stock subscription and corporate by-laws have been held valid in many states, where they were limited in scope and reasonably related to corporate purposes. See *e.g.*, *Martin* v. *Graybar Elec. Co.*, 285 F. 2d 619, 624–626 (C.A. 7); *Lawson* v. *Household Fin. Corp.*, 17 Del. Ch. 343, 350–351, 152 A. 723, 727; *Brown* v. *Little, Brown & Co.*, 269 Mass. 102, 109–110, 168 N.E. 521, 525; *Searles* v. *Bar Harbor Banking & Trust Co.*, 128 Me. 34, 37–38, 145 A. 391, 393; Annot., 61 A.L.R. 2d 1318, 1324; 12 Fletcher, *Cyclopedia of Private Corporations* § 5461.3 (1971 rev.). Typical of such restrictions is a reservation by the issuing corporation of a right of first refusal on any sale of the stock. The restraints are analyzed under the common tests for trade restraints to determine whether they are reasonable ancillary restrictions to an otherwise valid voluntary contract. The restrictions, and power to impose them, are never implied, and, where express, are strictly construed. Fletcher, *supra*, § 5461.3 at 198.

Appellees have not contended that Section 22(f) preempts state law requirements, and there is no basis for such a claim. Cf. *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware,* 414 U.S. 117, 139–140. Given the similarity in standards governing preemption and implied repeal (*id.* at 126–127), there is no greater basis for the district court's conclusion (App. 353) that Section 22(f) impliedly repealed the Sherman Act, particularly in view of the established doctrine disfavoring implied repeals of the antitrust laws (see p. 21, *supra*).

C. NO NASD RULE APPROVED BY THE COMMISSION REQUIRES OR AUTHORIZES RESTRICTIONS ON TRANSFERABILITY OF MUTUAL FUND SHARES

1. The district court also noted (App. 354) that restrictive provisions have appeared in registration statements and in uniform sales agreements since 1940, and that sales agreements are required by "SEC-approved" Rule 26 of the NASD Rules of Fair Practice.[42]

While Rule 26 requires sales agreements, it does not require them to contain provisions restricting the operations of a secondary market. In fact, in issuing its "nondisapproval" of Rule 26 the Commission cau-

[42] The Commission's action was technically "non-disapproval," rather than "approval." *A Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc.*, 9 S.E.C. 38 (1941). However, this action does not challenge, and the injunctive relief sought would not effect implementation of, that Rule. Nondisapproval means only that the rule does not contravene 15 U.S.C. 78*o*–3(b), and does not imply that the rule is necessary to the implementation of the regulatory scheme or that it is not in contravention of any statute other than the Maloney Act. 15 U.S.C. 78*o*–3(j).

tioned that the Rule did not authorize minimum or maximum commissions, did not authorize the NASD to enforce provisions in sales agreements establishing such commisions, did not restrict dealers from buying from or selling to whomever they wish at any price (consistent, of course, with the statutory requirements of Section 22(d)),[43] and did not prohibit secondary market transactions. *A Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc., supra,* 9 S.E.C. at 44, 46.[44] Rule 26, therefore, provides no support for the district court's conclusion that contractual restrictions on competition in the secondary market were contemplated by Section 22(f) or have received the Commission's approval.

2. Nor should the Commission's delay in condemning such restrictions be construed as approval of them. Section 22(f) does not require the Commission to approve or disapprove every restrictive provision contained in a prospectus. It simply empowers the Com-

[43] The Commission stated (9 S.E.C. at 44 and n. 9):

"It is important to note the precise effect of paragraph (j)(2), the extent to which it does not restrict a dealer's activities as well as the extent to which it does. It does not prevent a dealer buying from whomever he wishes at whatever price he wishes. It does not prevent his selling to any other dealer or to any investor [9] at any price he may wish to charge. * * *

"[9] If shares of the same class are currently the subject of a public offering he is prohibited by Section 22(d) of the Investment Company Act from selling to investors at a price below the public offering price. This statutory provision, however, has nothing to do with the rule under discussion."

[44] See also p. 36, *supra*, n. 32.

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mission to make rules prohibiting restrictions, should it determine that such a rule is necessary for investor protection.[45] Like legislative inaction (*e.g.*, *Zuber* v. *Allen*, *supra*, 396 U.S. at 185–186, n. 21), administrative silence is a weak basis from which to infer agency approval of particular conduct in a regulated industry. See, *e.g.*, *Baltimore & O. Ry.* v. *Jackson*, 353 U.S. 325, 330–331.

Section 22(f) does not declare that all restrictions that have not been disapproved by the Commission are immune from the antitrust laws; nor is this a case in which the Commission has adopted rules under Section 22(f) requiring—or even authorizing—restrictions of the kind being challenged.[46]

IV. THE REGULATORY SCHEME CREATED BY THE INVESTMENT COMPANY AND MALONEY ACTS DOES NOT FORECLOSE APPLICATION OF THE SHERMAN ACT TO COLLECTIVE RESTRAINTS ON SECONDARY MARKETS IN MUTUAL FUND SHARES

A. THE REGULATORY SCHEME ESTABLISHED BY THE INVESTMENT COMPANY ACT AND THE MALONEY ACT DOES NOT MEET THE TEST FOR IMPLIED REPEAL OF THE ANTITRUST LAWS

Because the unqualified dismissal of the complaint cannot be supported by Sections 22(d) and (f) of the Investment Company Act, the remaining crucial issue in this case is whether the Investment Company and Maloney Acts create a scheme of regulation so pervasive as to constitute an implied repeal of the

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[45] Even conduct approved by an agency required to consider competitive factors is not automatically exempt from the antitrust laws (see p. 58, *infra*).

[46] Whether such rules would immunize the conduct challenged here need not be considered. Cf. *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 376–377.

Sherman Act, thereby exempting the appellees from antitrust liability for conduct which would otherwise constitute a *per se* violation of that Act.

The government complaint does not question any action taken by the Commission nor seek to overturn any NASD rule.[47] It challenges restrictive practices in an industry subject, in many aspects, to a statutory duty of self-regulation and to Commission oversight. To determine whether the legislative scheme providing for such self-regulation and oversight implies antitrust immunity, it is necessary to consider the scope and characteristics of the provisions of that scheme applicable to the sale, distribution and redemption of mutual fund shares.

1. The Maloney Act of 1938, 15 U.S.C. 78o–3, provides, *inter alia,* for the registration of national securities associations with the Commission. Supplementing the original provisions of the Securities Exchange Act of 1934, it provides for a degree of self-regulation of member brokers and dealers by a registered association in order "to protect the investor and the honest dealer alike from dishonest and unfair practices by the submarginal

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[47] Among the things appellees allegedly did to effectuate the conspiracy to restrain trade in the purchase and sale of mutual fund shares was to establish and maintain rules that had the effect of inhibiting the development of the secondary markets (Compl. ¶¶ 15–18, App. 9–10). The government, however, is not challenging the validity of the NASD rules themselves, only the appellees' activities that have resulted in unofficial interpretations and extensions of the rules to restrict secondary markets. The rules themselves apply only to the primary distribution of mutual fund shares and do not purport to fix prices or commission rates in the secondary interdealer or brokerage markets (see p. 49, *supra*, n. 43; GX 6, 14–19, App. 251–252, 268–280).

element in the industry" and "to cope with those methods of doing business which, while technically outside the area of definite illegality, are nevertheless unfair both to customer and to decent competitor, and are seriously damaging to the mechanism of the free and open market." S. Rep. No. 1455, 75th Cong., 3d Sess., p. 3; H. Rep. No. 2307, 75th Cong., 3d Sess., p. 4.

In order to be registered, the association must have rules designed "to remove impediments to and perfect the mechanism of a free and open market," and *not* designed "to permit unfair discrimination between customers, or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges." 15 U.S.C. 78*o*–3(b)(8).[48] Changes in or additions to a registered association's rules must also be submitted to the Commission and take effect only if the agency, within 30 days, does not disapprove them as being inconsistent with the requirements of the Act concerning such rules. 15 U.S.C. 78*o*–3(j). In addition, the Commission is authorized to abrogate, alter or supplement such rules if necessary to protect investors or to effectuate the purposes of the Act. 15 U.S.C. 78*o*–3(k). NASD is the only association registered under the Act.

2. The basic purpose of the Investment Company Act is to protect the "public interest" and "interest

[48] NASD rule-making under Section 22(b) of the Investment Company Act, 15 U.S.C. 80a–22(b), "in connection with a primary distribution of redeemable securities," is not subject to the price-fixing prohibitions contained in the Maloney Act.

of investors" by requiring full and fair disclosure "concerning the character of [investment company] securities and the circumstances, policies, and financial responsibility of such companies and their management" (15 U.S.C. 80a–1(b)(1)), by preventing the operation and management of such companies, and the selection of their portfolio securities, in the interests of various insiders, affiliated persons, underwriters, brokers, or dealers, "rather than in the interests of all classes of such companies' security holders" (15 U.S.C. 80a–1(b)(2)), and by preventing injury to the preferences and privileges of holders of outstanding securities. 15 U.S.C. 80a–1(b)(3). Sections 22 (a) and (c) of that Act permit NASD (as a securities association registered under the Maloney Act) and the Commission, respectively, to adopt rules regulating the minimum price at which underwriters and dealers may purchase shares from the fund, for the purpose of eliminating or reducing dilution of the value of outstanding securities, or any other result that would be unfair to holders of such outstanding securities. 15 U.S.C. 80a–22 (a) and (c). Section 22(b) permits NASD and the Commission to regulate price and sales load in connection with a primary distribution of mutual fund shares. 15 U.S.C. 80a–22(b)(1).[49]

Section 22(d) does not give NASD or the Commission any regulatory authority. Rather, it permits resale price maintenance with respect to the issuance and primary distribution of mutual fund shares. Sec-

[49] Section 22(b)(4) provides that the provisions of Section 22 (b) shall prevail over all conflicting laws of the United States. 15 U.S.C. 80a–22(b)(4).

tion 22(f) authorizes the Commission to regulate, "in the interests of the holders of all of the outstanding securities," restrictions imposed by a fund upon transferability or negotiability of its shares. 15 U.S.C. 80a–22(f). Section 6(c) authorizes the Commission to exempt any person, security or transaction from any requirement of the Act or any rule thereunder, "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act. 15 U.S.C. 80a–6(c). In addition, Section 38 of the Act authorizes the Commission generally to issue rules and orders "necessary or appropriate to the exercise of the powers conferred" upon it by the Act. 15 U.S.C. 80a–37(a).

Taken together, these provisions establish a scheme of cooperative regulation, in which underwriters, brokers and dealers are free to determine for themselves what is necessary for regulation of the mutual fund distribution network, with the Commission exercising selected supplementary powers of direct regulation and secondary supervision in the interests of the investing public.

As the committee reports concerning the bill that, without material change, became the Maloney Act stated (S. Rep. No. 1455, *supra*, pp. 3–4; H. Rep. No. 2307, *supra*, pp. 4–5):

> The committee believes that there are two alternative programs by which this problem

> [of regulation of the over-the-counter market] could be met. The first would involve a pronounced expansion of the organization of the Securities and Exchange Commission * * * and a minute, detailed, and rigid regulation of business conduct by law. It might very well mean expanding the present process of registration of brokers and dealers with the Commission to include the proscription not only of the dishonest, but also of those unwilling or unable to conform to rigid standards of financial responsibility, professional conduct, and technical proficiency. The second of these alternative programs, which the committee believes distinctly preferable to the first, is embodied in S. 3255. This program is based upon cooperative regulation, in which the task will be largely performed by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary powers of direct regulation. * * *

Congress thus rejected a policy of pervasive direct regulation in favor of a less intrusive scheme more in keeping with free market traditions. Within the quality control constraints imposed by the rules of the association, Congress left each fund, underwriter and broker-dealer "free to determine his own business policy" and gave the Commission power of supplementary oversight. S. Rep. No. 1455, *supra*, pp. 8-9; H. Rep. No. 2307, *supra*, p. 9; see *Investment Trust Study* 290.

3. Even when faced with regulatory schemes more extensive and intensive than the present one, this Court has refused to hold that they were so pervasive as to oust the antitrust laws from the entire area, as the district court here has held.[50] Rather, the Court has carefully examined the specific conduct in question in order to determine whether subjecting that conduct to antitrust liability would create a basic conflict with the authority of the regulatory agency. Such a conflict will justify finding a limited antitrust immunity only where three factors are present: (1) the conduct challenged in the antitrust action must be the precise subject of a proceeding subject to the regulatory agency's remedial powers; (2) the regulatory scheme must require the supervising agency to focus upon competitive considerations in exercising those powers; and (3) the agency must have express statutory authority to immunize the conduct in question from the antitrust laws. *Hughes Tool Co.* v. *Trans World Airlines, Inc.,* 409 U.S. 363, 385–389; *United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 351; *Pan American World Airways, Inc.* v. *United States,* 371

[50] See *Otter Tail Power Co.* v. *United States, supra; United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 352; *Silver* v. *New York Stock Exch., supra,* 373 U.S. at 357; *Pan American World Airways, Inc.* v. *United States,* 371 U.S. 296, 311–312; *California* v. *Federal Power Commission,* 369 U.S. 482, 485; *United States* v. *Radio Corp. of America,* 358 U.S. 334, 350–351; *United States* v. *Borden Co., supra,* 308 U.S. at 198; *United States* v. *Trans-Missouri Freight Ass'n,* 166 U.S. 290, 314–325.

U.S. 296, 305–309. See also *Ricci* v. *Chicago Mercantile Exch., supra,* 409 U.S. at 302–303, n. 13.[51]

These requirements rest upon the importance of the antitrust laws and the policies they embody to the structure of our free economic system. See, *e.g., United States* v. *Topco Assocs., Inc.,* 405 U.S. 596, 610; *Northern Pac. Ry.* v. *United States,* 356 U.S. 1, 4–5. A general immunity from those laws ought not to be inferred unless it is clear that Congress intended to displace the protections of the antitrust laws with detailed administrative supervision or a duty of self-regulation that is necessarily inconsistent with the antitrust laws. The courts, of course, have the ultimate responsibility for determining the legislative intent in this regard (see *Ricci* v. *Chicago Mercantile Exch., supra,* 409 U.S. at 305), and must determine whether anticompetitive actions pursuant to agency supervision or a duty of self-regulation are necessary to make the regulatory scheme work, and whether they are more restrictive than necessary. *Silver* v. *New York Stock Exch., supra,* 373 U.S. at 357. The regulatory

[51] For example, in the recent *Hughes Tool* case, the conduct of Toolco that TWA alleged violated the antitrust laws had been the subject of extensive proceedings pursuant to Section 408 of the Federal Aviation Act, 49 U.S.C. 1378, resulting in the Civil Aeronautics Boards' approval of Toolco's acquisition of control of TWA. 409 U.S. at 382. Antitrust standards of competition and monopoly govern the Board's exercise of authority under Section 408 (409 U.S. at 385), and Section 414 of the Act, 49 U.S.C. 1384, expressly immunizes from antitrust liability any conduct approved, authorized or required by any Board order issued under Section 408. 409 U.S. at 386.

scheme and the antitrust laws are presumed to be complementary, not conflicting. Antitrust remedies are thus available even when an agency has supervisory powers over activities alleged to violate the antitrust laws and has considered antitrust consequences in passing on them. See *Otter Tail Power Co.* v. *United States, supra,* 410 U.S. at 373–375.[52]

4. As detailed above, neither the Investment Company nor the Maloney Act establishes a regulatory scheme meeting this Court's tests for finding implied antitrust immunity. The prerequisite conflict between the regulatory and antitrust schemes is absent.

The Commission's primary responsibility and authority with respect to mutual fund distribution is directed toward protection of investors, not restriction of competition between funds or between those who distribute fund shares. More specifically, the Commission has no authority to fix commission rates in the secondary markets, nor to prohibit brokers and dealers from trading in such markets. Its recent efforts to promote competition in the distribution of mutual funds (see pp. 38–40, *supra*) show that antitrust principles are in harmony, not in conflict, with the purposes

[52] That a statute authorizes or directs a regulatory agency to consider competitive factors in making a determination indicates that competition is relevant, but not that the agency's judgment should displace the courts' antitrust jurisdiction. See *United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. 350–352 (merger approved by agency required by statute to consider competitive factors is not immunized from challenge under antitrust laws); *California* v. *Federal Power Commission, supra,* 369 U.S. at 487–490 (agency should await outcome of antitrust suit before deciding whether merger is in public interest).

of the Investment Company Act. Although the Commission can and should consider competition as one of the key elements which bear on fair dealing and investor protection (cf. *Gulf States Utils. Co.* v. *Federal Power Commission*, 411 U.S. 747, 757–760), it has no power to correct antitrust violations as such, or to immunize such violations from relief under the Sherman Act.

5. Appellee NASD claims that, as a self-regulatory organization granted certain powers under the Maloney Act and Section 22 of the Investment Company Act, it is immune from antitrust liability. The standard for determining the extent of antitrust immunity conferred by a self-regulatory statutory scheme was established in *Silver* v. *New York Stock Exchange, supra,* and was recently reaffirmed in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra.* Those cases emphasize that "the proper approach is to reconcile 'the operation of both statutory schemes with one another rather than holding one completely ousted.' " *Ware, supra,* 414 U.S. at 127; *Silver, supra,* 373 U.S. at 357. Therefore, absent an explicit exemption or repeal the antitrust laws may be pre-empted by a statutory scheme for self-regulation only to the minimum extent necessary to make the regulatory act work. *Ware, supra,* 414 U.S. at 127; *Silver, supra,* 373 U.S. at 357–358.

Neither the Investment Company Act nor the Maloney Act contains express exemptions from the antitrust laws for price fixing and restrictive distribution agreements designed to restrict or eliminate secondary

markets in mutual fund shares.[53] The Maloney Act only empowers the NASD to supervise the conduct of of its members in order "to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market * * *." 15 U.S.C. 78*o*–3(b)(8). The exercise of that power does not require collusive conduct to fix prices in and restrict the development of secondary markets.

Nor is the restriction of secondary markets by sellers necessary to protect investors and prevent disruption of the primary distribution system regulated by Section 22. *SEC Report on Mutual Fund Distribution* 104, n. 4. Indeed, investors are injured when they are denied the opportunity of trading in competitive markets. Any justifications there may be for fixed prices and commission rates in the primary distribution

[53] The Maloney Act contains a general provision that it shall prevail over any prior law "in conflict" with it. 15 U.S.C. 78*o*–3(n). There is, however, no conflict between the Sherman Act and any provision of the Maloney Act relevant to this case, and the district court did not rely upon this general provision. Section 22(b) of the Investment Company Act, as amended in 1970, contains a similar provision, but it is limited in scope to prior laws "in conflict" with that subsection, which concerns only the level of sales loads "in connection with a primary distribution." 15 U.S.C. 80a–22(b)(1) and (4). The limited scope of this explicit provision for *pro tanto* repeal strongly suggests that the other provisions of the Act were not regarded by Congress as presenting any problem of inconsistency with the antitrust laws or other laws.

of mutual fund shares vanish once the shares, having passed through that chain of distribution, subsequently change hands in secondary markets between dealers or in brokerage transactions.

The activities of NASD and its members cannot be characterized as good faith efforts to effectuate its statutory duty of self-regulation. In 1959 the Commission staff informed NASD that it opposed NASD's proposed interpretation of NASD Rule 26 to restrict the secondary interdealer market, as not being supported by the language or history of the Investment Company Act (GX 6, 14–19, App. 251–252, 268–280), as NASD well knew.[54] Other documentary evidence indicates that the NASD was aware that Section 22 (d) of the Investment Company Act did not bar the secondary brokerage market (GX 27, App. 298).

Even under NASD's theory, however, dismissal of the complaint was unjustified. At most, those defenses created issues of fact requiring a trial in order to

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[54] The NASD Manual, in illustrating the application of Section 22(d) and Article III, Section 25 of NASD's Rules of Fair Practice (prohibiting any member from dealing with any nonmember broker or dealer except on the same terms and conditions as are accorded by such member to the general public), recognizes that secondary brokerage transactions at less than the public offering price are permissible under both Section 22(d) and the Rule (*id.* at ¶ 5269):

* * * * *

"(All sales in the examples below are assumed to be at less than the public offering price stated in the prospectus * * *.)

* * * * *

"(9) A customer sells to another customer through a member who acts as agent for either or for both customers:

"This is a proper transaction under Section 22(d) and under Section 25 of Article III of the Rules of Fair Practice."

determine whether the appellees' conduct was in fact necessary to implement effectively the Investment Company Act and the Maloney Act, and was no more restrictive than necessary. See *Harwell* v. *Growth Programs, Inc., supra,* 451 F. 2d at 246–247.[55]

B. THE INVESTMENT COMPANY ACT AND THE MALONEY ACT DO NOT ANTHORIZE COLLUSIVE ACTION TO OBTAIN RESTRICTIONS ON THE PRICE AND DISTRIBUTION METHODS IN SECONDARY MARKETS FOR MUTUAL FUND SHARES

Count I of the complaint alleges a horizontal combination and conspiracy by NASD members to prevent the growth of a secondary dealer and brokerage market in mutual fund shares by refusing to sell mutual fund shares to dealers in the secondary market and discouraging or forbidding participation in a

[55] The district court correctly ruled that "the cases at bar do not involve the doctrine of primary jurisdiction" (J.S. App. 66, n. 59). The Commission's construction of Section 22 is clear. and the complaint does not claim that appellees have violated any statute vesting remedial jurisdiction in the Commission, or any regulation of that agency. Thus, there are no issues to refer to the Commission under the doctrine of *Ricci* v. *Chicago Mercantile Exch., supra,* and *Chicago Mercantile Exch.* v. *Deaktor,* 414 U.S. 113. As those cases make clear, the questions whether and to what extent a regulatory statute impliedly repeals the antitrust laws are ultimately to be resolved by the courts, not the agency. *Ricci, supra,* 409 U.S. at 305–306; *Deaktor, supra,* 414 U.S. at 115.

Moreover, unlike those cases, there is not any action the Commission could take here that might bear on the question whether the appellees have violated the Sherman Act or that might, by finding their activities in violation of the Investment Company Act or the Maloney Act, make a resolution of that question unnecessary.

brokerage market (Compl. ¶¶ 15–18, App. 9–10), conduct that constitutes a *per se* violation of the Sherman Act (see pp. 17–18, *supra*). Without regard to whether Section 22(f) permits a fund or its underwriter to impose such vertical restrictions on the distribution of that fund's shares, a horizontal agreement or conspiracy among competing funds, underwriters or dealers to impose restrictive provisions would be illegal under *Georgia* v. *Pennsylvania R. Co.,* 324 U.S. 439, 459–460.

There the Court held illegal a conspiracy to fix railroad rates, even though the individual tariffs submitted by each railroad involved in the conspiracy had been accepted by the Interstate Commerce Commission.[56] Here, as in that case, the underlying regulatory statutes did not authorize collusive action by members of the regulated industry. Where Congress has established a regulatory scheme that contemplates "competition and individual freedom of action" rather than "[t]he coercive and collusive influences of group action" (*id.* at 458–459), the Sherman Act requires that each party regulated retain its freedom of action in that area.

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[56] A similar principle was recognized recently in *Hughes Tool Co.* v. *Trans World Airlines, supra*, which upheld a claim of antitrust immunity on the basis of two specific regulatory provisions authorizing the Civil Aeronautics Board to approve the challenged transactions applying antitrust standards and immunizing such approved transactions. The Court also held, however, that those provisions did not completely displace the antitrust laws, noting specifically that a combination or agreement between two air carriers involving trade restraints would obviously be subject to the antitrust laws. 409 U.S. at 387.

CONCLUSION

For the reasons stated, the judgment of the district court dismissing the complaint should be reversed.

Respectfully submitted.

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